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THE FUTURE OF SMALL LOAN LEGISLATION

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STATUTORY control of the small loan business is constantly changing. Each biennium finds many amendments proposed and some adopted. In what direction is regulatory law developing? How should it evolve in order to produce sound business practices and secure justice to lender and borrower?

HISTORICAL BACKGROUND

Prior to 1884 the law paid no special attention to *small* loans. Usury statutes provided maximum legal rates on all loans, large or small. These rates ran from 5 per cent to 12 per cent and were deemed to give a reasonable profit to the lender, whether he advanced \$100 or \$100,000, and to give adequate protection to the borrower against extortion, whether the borrower was a poor man borrowing \$50 to pay a doctor's bill, or a wealthy industrialist giving his note for \$5,000.

The percentage rate necessary to cover the cost of small loans was then, and is now, much greater than the rate necessary to cover the cost of large loans. Small loans could not then be made, with any profit to the lender, at the rates fixed by the usury statutes. There was a great demand and need for small loans by persons of little means. To fill this demand unscrupulous persons made loans at much more than the legal rates and often on terms which were harsh and unconscionable. Those were the early and palmy days of the loan shark in the history of American consumer credit. The details of the dark picture have been painted by many able writers.

In the last quarter of the nineteenth century there arose sporadically an appreciation of the woeful condition of the small borrower and of the need for special legal attention to his relief. Beginning with a New Jersey

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statute in 1884, prohibiting the assignment of wages to secure a loan, except at the legal rate of interest, and providing a criminal penalty for a lender who violated the statute, and continuing down to the present day, there have been numerous legislative attempts to give special treatment to the small loan and special protection to the small borrower. These statutes may be divided into two classes: first, those applying to small loans, no matter what institution or individual made or received the loan, and attempting to cure one or more specific abuses; and, second, those statutes which permit the creation of particular types of small loan agencies which are to operate under prescribed rules.

The first class of miscellaneous legislative acts may be illustrated by statutes making pledges or mortgages invalid if in connection with usurious loans, increasing the rate of interest above the usury rate in the case of all small loans, or placing restrictions on the use of the wage assignment.

The second group of statutes includes the laws which provided for the incorporation and operation of remedial loan societies, industrial banks, small loan companies, credit unions, and those statutes which regulated the operation of pawnshops.

The licensing and regulating of pawnbrokers has been a concern of legislators, particularly since 1875 and in states having large cities. All states now have some controlling legislation. All require a license and the payment of a tax. Twenty-two states require a bond, and all but fifteen limit the rate to be charged, the usual rate being from 1 per cent to $3\frac{1}{2}$ per cent a month, with extra charges forbidden. In a very few states inspection, storage, insurance, and other charges are allowed.

Figures regarding the amount of outstanding loans made by pawnbrokers are not easy to obtain. A recent reliable estimate is that these agencies had outstanding loans of approximately \$100,000,000 in 1937.

In 1894 the Provident Loan Society was incorporated in New York for the purpose of making loans on pledge or mortgage. Its aims were to secure a very moderate income on capital lent and to serve the needs of wage-earners for small credit at very modest rates. Subsequent legislation in New York provided for other semi-philanthropical loan societies of this sort and limited loans to \$200, and interest to 3 per cent a month for the first two months and 2 per cent a month thereafter, with a \$3 fee for investigation and the drawing of papers. A few years earlier similar societies had been established in Ohio, Massachusetts, and Rhode Island. The movement spread widely but recently has shrunk until at the present time there are only seventeen of these remedial or semi-philanthropic loan

societies in the United States. They lend on pledge or chattel mortgage. Their rates are fixed at a per cent per month on the unpaid balance, ranging from 1 per cent to 2 per cent. They are customarily allowed to charge certain extra fees, as, for example, a small percentage of the loan for storage and insurance of pledged articles.

In 1910 Arthur J. Morris established in Virginia a Morris plan or industrial loan bank, to lend to wage-earners on the co-maker plan. In 1940, ninety-four of these companies were in existence, seventy-one having been organized between 1911 and 1917; and thirty-one states had special laws relating to such loan companies. These statutes customarily limit the size of loans to a percentage of the paid-in capital and surplus or to a flat sum ranging from \$200 to \$5,000; limit the legal charges to a maximum per annum rate of discount running from 6 per cent to 12 per cent and permit, in addition, the charging of an investigation or service fee and a delinquency fee; and permit the industrial bank to issue certificates of investment to its borrowers which are paid for in instalments and are pledged as security for the loans. Thus, in substance, the borrower from the industrial bank customarily repays his loan in instalments, may get a small rate of interest on these instalment payments, but pays interest on the amount originally lent throughout the whole period of the loan. The true interest being charged, of course, runs to much more than the 6 to 12 per cent discount rate. At the 1936 convention of the American Industrial Bankers' Association a proposed uniform industrial banking law was approved, which limits the term "industrial loan company" to an organization which requires repayment of its loans in weekly, semi-monthly, or monthly instalments, and may or may not issue certificates to the borrower for these instalment payments. This proposed law permits the lender to deduct in advance \$8 for each \$100 lent, and also to charge investigation and delinquency fees, and makes it optional with the company to allow interest on the instalment payments which the borrower is required to make. In February, 1944, industrial banks had outstanding loans of \$161,000,000.

In the first decade of this century (from 1904 to 1910) there began the legislative practice of authorizing specially organized corporations, or partnerships, or individuals to conduct as their only business the making of small loans, requiring these agencies to be licensed, regulating operations, and permitting the charging of interest considerably in excess of the usury rate. Thus began recognition and control of a new lending agency—the so-called small loan company.

The Russell Sage Foundation is a corporation organized under the laws

of New York state in 1907 by Mrs. Russell Sage as a memorial to her husband. Its objects are the "improvement of social and living conditions in the United States." It is a charitable organization, and not organized for profit. It has no financial interests in any lending agency, except that a small part of its funds are invested in the Provident Loan Society of New York, the philanthropic lending agency previously described. Its original interest in the small loan field was in the formation in various cities of remedial loan associations to furnish loans to the poor at low rates and with profit a secondary motive. It formed a division within its organization originally known as the "Division on Remedial Loans," but now known as the "Department of Consumer Credit Studies." This division later became interested in small loan legislation as a whole and helped in securing miscellaneous desirable legislation. In 1916 the Russell Sage Foundation was asked by the Small Loan Companies Association to draft a model or uniform small loan law, and the first draft of such a statute was completed in that year. As experience has shown the need of revision of this draft, changes have been made by the Russell Sage Foundation. A second draft appeared in 1918, a third in 1919, a fourth in 1923, a fifth in 1932, a sixth in 1937, and a seventh draft in 1942. The important features of this uniform small loan law are: the definition of a small loan as one of \$300 or less; the requirement that the lender desiring to come under the law must make proof of financial ability, character and fitness, and public convenience and necessity, as well as file a bond, as prerequisites to obtaining a license; that the licensee must submit to state inspection; the prohibition of false or misleading advertising; the limitation of charges to a figure varying from $1\frac{1}{2}$ per cent to $3\frac{1}{2}$ per cent a month on the unpaid balance of the loan, this to include all costs of the loan taken in any form by the lender; the exclusion from the act of banks, trust companies, building and loan associations, credit unions, and pawnbrokers; and the provisions that the license may be revoked or suspended for violations of the act, that violations of the more important sections are misdemeanors, and that loans, the making of which constitute misdemeanors, shall be uncollectible as to principal or interest.

With the backing of the Russell Sage Foundation and the Small Loan Association, the adoption of this Uniform Small Loan Law began in 1917 in Illinois, Indiana, and Maine, and has continued from year to year. Thirty-one states and Hawaii have small loan statutes closely approximating one or another of the various drafts of the Uniform Small Loan Law. The following states have no adequate and effective laws governing the small loan business: Alabama, Arkansas, District of Columbia, Georgia,

Kansas, Mississippi, Montana, Nevada, New Mexico, North Carolina, North Dakota, Oklahoma, South Carolina, South Dakota, Tennessee, Texas, and Wyoming.

In Great Britain the Loan Societies Act, 1840,¹ permitted the formation of loan societies to make loans to the "industrious classes" to a maximum of £15, with authority to deduct in advance interest of not more than 12 per cent and to charge an investigation fee of not more than one shilling and sixpence for each loan. The Moneylenders Acts, 1900 and 1927, provide for the licensing of moneylenders and the regulation of their businesses.² Throughout the British Empire similar legislation is to be found. See, for example, the Money Lenders Act of Ontario³ and the Loan and Trust Corporations Act of Ontario.⁴ The Canadian Dominion Parliament has passed the Small Loans Act of 1939, effective January 1, 1940, which is similar to the Uniform Small Loan Law of the United States.

It is estimated that on February 29, 1944, small loan companies had outstanding loans of \$356,000,000.

In 1909 Massachusetts passed an act permitting the establishment of a new type of agency to make small loans, namely, the credit union or co-operative bank. Groups having a unity of interest because of residence, occupation, common employer, or other factors, were permitted to organize for the deposit and investment of savings and the making of loans to members only. Management was to be by members, with consequent nominal salary expense, and investigation and office costs could be kept at a low level because the members were well known and within easy reach, and headquarters were to be located in a factory, store, or other similar place. Statutes similar to this original Massachusetts law have been adopted by Congress and nearly all states. The latest available figures show the existence of about 3,800 federal and 5,300 state credit unions having more than 3,000,000 members, with outstanding loans in February, 1944, of \$105,000,000. Under the typical credit union statutes unsecured loans are limited to a small sum, as for example, \$50 or \$100; and secured loans are limited to approximately \$1,000; state or federal inspection and supervision is provided; and rates are limited to 1 per cent a month on unpaid balances, with no extras.

Beginning in 1934 commercial banks became interested in the small loan field, because of the large amount of deposits on hand and the scarcity of good commercial loans. Previously most banks had had little desire to

¹ 3 & 4 Vict. c. 110.

³ C. 243, R.S. 1937.

² 63 & 64 Vict. c. 51; 17 & 18 Geo. V. c. 21.

⁴ C. 257, R.S. 1937.

encourage applications for loans under \$300. The usury rates applied to such loans, and they could not be made profitably within the legal rates. Bookkeeping, investigation, and collection costs were as much or more in dollars as in the case of commercial loans, and, of course, were much more in proportion to the amount lent. Thus, small loans could not be profitably made in obedience to the usury laws. Many banks collected interest in advance and made service charges or minimum loan fees which were evasions of the usury laws, but permitted the banks to carry on some small loan business. This extra-legal method was so hazardous and unsatisfactory that a movement soon developed in bankers' associations to secure legislation which would permit banks to make small loans at rates higher than the rates fixed by the usury laws. To date twenty states have adopted legislation which sanctions the entry of commercial banks into the small loan field and the charging of rates for such loans which are higher than those collectible on the larger commercial loans. In addition in five other states there are no usury laws, and in two others the maximum rate is 12 per cent, so that in these seven states commercial banks are able to do a small loan business.

The American Bankers' Association has in the past circulated a draft of a bill permitting banks to make small loans at rates higher than the usury rates, but at the present time does not advocate any model small loan act for banks, since it feels that local conditions vary and that any statute adopted should be an amendment to the local banking act and fit into the local interest legislation. It does advocate the adoption in each state of a statute permitting banks to charge for small loans the statutory legal or contract rate collected in advance, with rebates to be paid in case of prepayment. It does not advocate statutory permission to banks to charge investigation and default fees or other extras. However, some banking laws already enacted permit such extras, and it is common to authorize a contract for the repayment of the loan in instalments. It is estimated that in February, 1944, commercial banks had small loans outstanding in the amount of \$266,000,000.

In Connecticut in 1941 savings banks were permitted to enter the small loan field, and were allowed to charge 1 per cent a month on unpaid balances. The maximum loan allowed is \$1,000.

From the foregoing discussion it will be seen that small loan legislation on the books today may be classified as follows: (1) the usury laws; (2) miscellaneous, casual, and unsystematic reform measures attempting to improve the condition of the small borrower and applying to all or only a part of the lending agencies and to one or more business practices or

elements of the loan transaction; (3) systematically prepared statutes, each of which relates to one type of lending agency only. These latter laws have been prepared separately and often without regard to the small loan problem as a whole. They are the result of pressures by various social agencies or business interests which desired to get enabling or regulating legislation in one particular part of the small loan business. Thus, there is a hodgepodge of inconsistent rules and controls which has grown up haphazard. Some lenders are more favorably treated than others. Some are more severely regulated than their competitors. Some borrowers are better protected or have lower rates than their neighbors. The time would seem ripe for a broad legislative review of the small loan field as a whole, with the object of framing a systematic and symmetrical code, in which the best and fairest rules and standards which have been discovered in more than a half-century of experimentation shall be applied to all the lenders and borrowers of the state, to the end that fair play and equal treatment for business and the public may be attained.

THE EXPERIENCE OF ILLINOIS

The accidental and haphazard growth of state laws regarding small loans and their present unsatisfactory condition can be illustrated from the statute books of a typical state, namely, Illinois. The first step was the establishment in 1819⁵ of a maximum rate of interest of 6 per cent for banks and monied institutions, although no limit was fixed as to other lenders. In 1849 a 10 per cent maximum was fixed for all lenders, but in 1879 this was reduced to 8 per cent and in 1891 the present maximum of 7 per cent was established, the penalty for usury being the forfeiture of interest.

In 1887 a comprehensive statute regarding the organization of state banks was adopted, granting such corporations "power to loan money on personal and real security," but there were no special provisions regarding the terms of loans. Reports to and examinations by the auditor of public accounts were required.⁶ This statute was revised in 1919⁷ and again in 1929⁸ and has been amended several times since, but no special provisions regarding small loans by commercial banks have been added. In 1943 a bill was introduced permitting banks to make loans up to \$300 at 1 per cent a month, the period of the loan not to exceed eighteen months. A Senate committee appointed to investigate small loans made a factual report and recommended the passage of the bill, but the legislature took no action.

⁵ L. 1819, p. 106.

⁷ L. 1919, p. 224.

⁶ L. 1887, p. 89.

⁸ L. 1929, p. 174.

In 1889 it was provided by the Illinois legislature that chattel mortgages on household goods, wearing apparel, and mechanics' tools must be foreclosed in a court of record, and could not be foreclosed by a power of sale.⁹

In 1899 a provision was made for the organization of pawnners' societies of the remedial loan or semi-philanthropic type, and this statute remains on the books.¹⁰ Under it the First State Pawnners' Society of Chicago is incorporated and has been doing business since 1899. Rates are limited to 1 per cent a month and not to exceed $\frac{1}{2}$ per cent a month additional for storage or insurance. Loans are to be made on pledges, the redemption or sale of which is regulated by the statute. Annual dividends are limited to 7 per cent. The state auditor has supervisory and examining powers. For overcharging, the lender forfeits his pledgee's rights; and for wilful violation of the act the corporation forfeits its right to do business and the officers and employees are guilty of a misdemeanor.

The regulation of pawnbrokers seems to have begun in Illinois in 1909.¹¹ Rates were then limited to 3 per cent a month, and storage and insurance charges were prohibited. The borrower must be given a memorandum of the transaction. The pawnbroker must keep a register of transactions which is open to the police. Pawned articles are not to be sold for one year. For violations of the act the pawnbroker is subject to fines. Licensing is left to cities and villages.

In 1913 the Illinois legislature authorized the formation of another type of lending agency, namely, the "wage loan corporation,"¹² which was to have power to lend money on wage assignments at a maximum of 3 per cent a month, with no extras. Loan contracts in violation of the act were to be void, and interest paid under them not recoverable. Notes were to state on their faces "secured by wage assignment" and not to be negotiable so as to cut off defenses. A bond was required of the corporation, accounts were to be kept, and a receipt to be given to the borrower. Dividends were limited to 6 per cent annually. The state auditor was given examining and inspecting powers. This seems to have been an effort to create a semi-philanthropic agency to lend on wage assignments and to be a companion to the pawnners' societies authorized in 1899. No provisions regarding the amount of wages which could be assigned or the prerequisites to a valid wage assignment were included. The act seems to have become a dead letter. No "wage loan corporation" appears to be in existence.

In 1917 the Russell Sage Uniform Small Loan Law (first draft) was adopted.¹³ As revised and amended in 1935¹⁴ it covers all persons and

⁹ L. 1889, p. 208.

¹¹ L. 1909, p. 300.

¹³ L. 1917, p. 553.

¹⁰ L. 1899, p. 120.

¹² L. 1913, p. 199.

¹⁴ L. 1935 p. 925.

corporations in the business of making loans up to \$300, except banks, trust companies, building and loan associations, pawnbrokers, credit unions, and wage loan corporations. It requires a license, to be issued after proof of financial responsibility (including the possession of \$5,000 capital), experience, character and fitness on the part of the applicant, and convenience and advantage to the locality. A \$1,000 bond is required, and an annual license fee must be paid. The state Department of Insurance is the licensing, supervising and examining agency. It must revoke a license for violation of the act or its regulations. False or misleading advertising is prohibited. The maximum legal rate is fixed at 3 per cent a month on the unpaid balance up to \$150, and $2\frac{1}{2}$ per cent a month on any part of a loan balance over \$150. No interest is to be paid in advance, nor are any other charges to be made. If an excess charge is made, the note is void, and no interest or principal can be collected. The lender must give to the borrower a full written statement of the transaction, including a copy of the rate section of the act, and must give a detailed receipt for each payment. Sales of wages are treated as loans under the act. The borrower may assign not to exceed 25 per cent of his wages or salary and the assignment binds the employer from the date of receipt of a copy, verified by the oath of the lender, but no such copy is to be served unless the borrower is in default. Chattel mortgages on household furniture must be signed by both husband and wife. Violations of the act are made misdemeanors.

In 1925 the organization of credit unions was authorized in Illinois, under the supervision of the auditor of public accounts.¹⁵ The members must be limited to "groups having a common bond of occupation or association, or to groups from a well-defined neighborhood, community or rural district." Loans may be made to members only, at a maximum rate of 1 per cent a month on the unpaid balance. The board of directors and committee members making and supervising loans are not to be compensated. Dividends may be declared without limit. The capital is to consist of payments made by members for shares.

By Illinois Laws of 1935¹⁶ wage assignments in general were regulated. They are required to be written, signed by the assignor, and bearing the date, name of employer, amount of loan or price of goods or other consideration, rate of interest, if any, and due date. A copy must be furnished the assignor. The assignment must be by a separate instrument and headed "wage assignment" in letters at least one-quarter inch high. Demand on the employer is not to be made unless there has been a default, and the amount of the default and the original or a photostatic copy of the as-

¹⁵ L. 1925, p. 255.

¹⁶ L. 1935, p. 208.

signment must be exhibited to the employer. The assignment applies only to an existing wage contract and not more than 25 per cent of the wages may be assigned. Wrongful service of a demand with fraudulent intent is made a misdemeanor. The act does not apply to small loan companies or credit unions.

The Illinois legislature has made no special provision for one type of lending agency used in many other states, namely, the industrial or Morris Plan bank.

This outline of the development of the law of Illinois in relation to small loans shows much variety and lack of uniformity. Some agencies are regulated by the auditor, some by the insurance department, some not at all. The maximum lawful rates run from 7 per cent a year to 3 per cent a month. Some charge extras, others not. For excessive charges some lenders forfeit interest only, others interest and principal. For violation of the regulations, some are liable to criminal penalties, others not. Some must make a very strong showing to get and retain a license; others are not licensed at all by the state. The law in regard to wage assignments and chattel mortgages by small loan companies differs from that relating to other lenders. Some of these variations in treatment may, upon examination, prove to be justified by a difference in the status of lenders or borrowers, but many differences are not reasonable. A thorough examination and survey of the whole field should be made by the legislature in order to make the law rational, comprehensive, and impartial to all lenders and borrowers. This same situation could be duplicated in nearly every state in the union.

PRESSURES FOR LEGISLATIVE ACTION

That comprehensive consideration of the whole small loan problem would be timely is shown, not only by the fragmentary, conflicting, and unsatisfactory state of the controlling legislation, but also by the agitation for new laws which is apparent in legislative halls, in legal and business journals, and in business conferences and conventions. In 1942 and 1943 one or more bills affecting one or more small loan agencies were introduced in at least sixteen different states, namely, Connecticut, Illinois, Indiana, Iowa, Kentucky, Maryland, Mississippi, Missouri, Nebraska, New Jersey, New York, North Carolina, Pennsylvania, Texas, West Virginia, and Wisconsin.

Bills to reduce the maximum rate for small loan companies frequently crop up, and now and then are passed. Thus, Georgia has reduced the maximum rate to $1\frac{1}{2}$ per cent a month, and in 1929 West Virginia reduced

her rate to 2 per cent a month, and New Jersey to $1\frac{1}{2}$ per cent. But experience has proved that such rates are too low to permit legitimate small loan companies to do business at a profit, unless the lower rates are applied to larger average loans than are possible under a \$300 maximum. Canada and some states with higher ceilings have been able to enforce lower maximum rates. But where the \$300 ceiling is retained the adoption of these rates drives out the high-class lender and brings in the loan shark. As a result the higher rates are usually restored. Thus, West Virginia changed its rate in 1933 to $3\frac{1}{2}$ per cent on the first \$150, and $2\frac{1}{2}$ per cent on the second \$150, and New Jersey now has a maximum rate of $2\frac{1}{2}$ per cent a month.

The banks are pressing every year for legislation opening up the small loan field to them. They are in conflict with the small loan companies and sometimes with state banking officials as to the terms of such enabling legislation. Regulatory legislation would seem to be needed.

In the states which have no adequate small loan laws there is constant pressure for the adoption of the Uniform Small Loan Law, in which social agencies and some small loan companies join, and to which there is strong opposition from the unlicensed lenders, who are sometimes called "high-raters" or "loan sharks." Thus, recent efforts to get Congress to adopt a small loan law for the District of Columbia have failed.

The federal government is trying to find a way into this complex loan problem. In 1941 Congressman Sheppard of California introduced into Congress a resolution for the investigation of the small loan business, in support of which he made a violent attack on small loan companies. The resolution alleges the collection of excessive rates by all consumer lending agencies, and asks for the appointment of a committee to make "an inquiry into the size of, character of, and profits derived from the business" of making loans to individuals from \$50 to \$500. Mr. Sheppard renewed this attack in April, 1944, by having a speech printed in the *Congressional Record* appendix, in which he made many extreme statements regarding the small loan companies and various persons connected with them and with the Russell Sage Foundation.

In Texas a federal grand jury recently investigated the small loan business and subpoenaed a large number of lenders, both companies which are national in operation and are licensed small loan companies in some states, and other companies which are not licensed lenders in any state. The federal grand jury on June 6, 1944, returned two indictments dealing with companies and individuals in the small loan business. The first and principal indictment was against thirteen chains doing the 240 per cent a year

type of business. The government charged that forty corporations and 400 offices were operated by these chains from the Carolinas west (the states which lack adequate small loan laws). Two huge chains alone operate 200 offices. According to an assistant attorney general in 1943 these operators had received between 90 million and 180 million dollars interest on loans totaling at least 75 million dollars.

In its secondary indictment, which included some legal small loan companies, the federal charge is too little activity in seeking small loan laws in certain states, not too much. An agreement to divide territory is charged. The charge rests on the assumption that small loan laws represent public protection. There is no indictment against the type of small loan law advocated by the Russell Sage Foundation. The indictment contains the following statement:

... said agreement and concerted action of the defendants have had the further effect of preventing the passage in states reserved to the high-rate defendants in high-rate territory and states, of regulatory small loan laws for the protection of indigent borrowers in such states...

This is in substance a charge that the legal companies were not sufficiently aggressive in promoting the passage of the Uniform Small Loan Law. In effect, it is an endorsement of the Uniform Small Loan Law.

The defendants connected with the legal-rate business deny any such agreements as are claimed in the indictment. Efforts were made to pass small loan laws in states in which the indictment alleged the defendants had agreed not to sponsor small loan laws.

An Associated Press news release of June 19, 1944, states regarding the indictment:

A new question of law, whether money is a commodity in commerce, is involved in the Government's small loan case.

Justice Department attorneys said today it's the first time money has been treated as a commodity in commerce.

The case rests on the premise that money itself is a commodity and when it crosses state lines it puts the money-lenders in interstate commerce. If they are not in interstate commerce they are not subject to regulation under the Sherman Antitrust Act.

The indictment returned in San Antonio, Texas, charges that in the operations of the defendants "there is a continuous flow of money, bills of exchange, checks, drafts, and other media of exchange" between the headquarters of the various small loan "chains" and their branch offices.

This flow, the indictment says, is across state lines.

The Supreme Court has just ruled that the insurance business is in interstate commerce and is subject to regulation under the Antitrust Act. But in the insurance case, it was not money which was treated as a commodity, but insurance policies.

An important recent address with respect to the future development of small loan legislation is that of Jackson R. Collins, Esq., general counsel for the Beneficial Management Association. This speech was made at a meeting of the New York State Association of Small Loan Companies in Albany in October, 1943. Beneficial Management is one of the largest small loan companies. Mr. Collins seems to argue (1) that regulation of the small loan business should be reduced or abolished; (2) that if there is to be a continuance of regulation it should not be uniform but should be adapted to the needs of the various lenders and borrowers; and (3) that the present requirement that the small loan company rate be a percentage on the unpaid balance should be abolished and a discount rate and extra charges be permitted. He stated that the Uniform Small Loan Law establishes "an extraordinary rate of charge (a per cent per month)" and denies "the normal and natural right of customary and usual expenses, charges and conventional interest." With regard to the penalties for violations of the small loan act he stated: "The entire system of extraordinary penalties rests upon the principle that the lenders are not men of such character and fitness. In fact these extraordinary penalties are either an absurdity or they are an insult to both the lenders and the state authorities." With respect to uniformity of treatment of the small loan business, Mr. Collins said: "America rejects any regimentation, any fixed pattern, any one pattern; no one method is the only method and all others are deceptive, false or misleading. . . . The various segments of the small loan business must learn to live and let live and recognize that there are many honest and able ways to do this same thing, especially where there are different factors, emphases, and considerations."

Most of the current argument and pressure tends in the direction of piecemeal legislation which would increase the already great diversity and conflict in the law of this field. But occasionally there is a movement toward unity and consistency which gives hope for the future. For example, in 1943 the Nebraska legislature adopted a systematic program to cover all consumer loans, including those made by banks, small loan companies, industrial banks, and credit unions. And again two important organizations have recently committed themselves to the drafting of a comprehensive commercial code, covering sales, negotiable instruments, security, banking, and other similar topics. I refer to the action of the National Conference of Commissioners on Uniform State Laws and the American Law Institute, begun in 1941, and now advanced to the stage where a Revised Uniform Sales Act is completed.

That standardization of commercial laws is not an idle dream is proved

by the experience of the National Conference of Commissioners on Uniform State Laws. Beginning in 1896 and ending in 1909, it prepared five important commercial acts, covering a large part of business law. Forty-eight years have elapsed since this process began, and during this time these acts have been gradually adopted by state legislatures, until now nearly all of the more important commercial states have the entire set. Thus, the Uniform Negotiable Instruments Law is adopted in all states, the Warehouse Receipts Act in forty-seven, the Sales Act in thirty-seven, the Stock Transfer Act in thirty-one, and the Bills of Lading Act by Congress and thirty states. Forty-eight years is a short span in the jurisprudential life of a nation. In a much shorter time order and unity could be brought to the small loan codes of the several states.

If a program of systematic study were undertaken by a legislature, with the aid of businessmen and lawyers, in order to harmonize and modernize all small loan law, what would be the principal problems for investigation? Such a study might be divided into two main parts, namely, (1) an outline of the topics covered by the combined existing legislation, arranged in logical sequence; and (2) a collection of facts about each variety of small loan business in order to determine what old rules of law should be continued, extended, modified, or abandoned, and what, if any, new rules should be added.

In this paper there is not space to offer a complete outline of existing legislative controls, a narration of the peculiar facts regarding each type of lender and his borrowers, and an argument from those facts as to what should be the rules applied in a model small loan code to each variety of small loan institution. All that can be done here is to select three main problems and discuss them. I refer to the questions (1) whether the states should regulate some or all small loan business in any way; (2) whether, if there is to be some regulation, it shall include the fixing of the rates to be charged; and (3) if rate regulation is to occur, in what form shall the rate be prescribed. There is no space for discussion of the definition of a small loan; conditions precedent to entry into the small loan business such as proof of qualification, public need, licensing and bonding; records, reports and inspections; the form of the note and information to be given the borrower; advertising; the taking of security; the prohibition of particular abuses; methods of collection; what state agency shall control; and civil and criminal penalties for violations of the act by the lender.

REGULATION OR NO REGULATION?

Let us, then, first address ourselves to the very broad question of social and economic policy whether state regulation of the small loan busi-

ness shall be continued in the many states which now have it, shall be adopted in the few states which have little or no legislation on the subject, and shall be made to cover any lending agencies not yet affected.

The arguments made by the proponents of reduction or abolition of state regulation are largely based on abstract statements of social, economic, and governmental theory. It is not alleged that regulation has prevented the lenders from making a legitimate profit or hindered the borrowing class from getting adequate credit when needed. It is urged that the spirit of American government should be "free enterprise," and that all regulation is hostile to freedom of business enterprise; that in recent years regulation of business has developed beyond all bounds and should be greatly reduced; that the small loan business is based on a natural demand and is not the creature of government, and hence it should be left to itself; that regulation forces all small lenders into a groove of uniformity, while diversity of development and free experiment are more in harmony with our institutions; that regulation restricts competition and so amounts to restraint of trade and conflicts with the policies of the common and statute law; that small lenders and borrowers are deprived by regulation of their freedom to make such contracts as are suited to their needs and abilities; that since commercial banks are unregulated in their small loan business or are restricted very slightly, their competitors should not be regulated; and that the civil and criminal penalties imposed on some small lenders for violations of the regulatory laws are too harsh and are a reflection on the honesty and character of the large majority of small lenders who are honest and of unimpeachable reputation.

The burden is on the advocates of no regulation or decreased regulation to show that the small borrower does not need protection by the state under its police power. This they have not tried to do. In the early part of this century, when the courts considered the constitutionality of various small loan regulatory laws, they found inequality of economic position between lenders and small borrowers, danger of unconscionable oppression, and lack of real freedom of contract, and hence declared that the police power of the state made it constitutional to regulate the small lender and so protect the necessitous borrower. The police power is still a valid doctrine in American constitutional law. It would seem that the power of corporations and concentrated wealth has increased since the beginning of the period of regulation and that the economic condition of those of modest means has not improved. The National Resources Committee reported in 1938 that two-thirds of the wage-earners in the United States had incomes of \$1500 or less. The need for these regulatory laws is as great as it ever was.

It is not as if regulation of small loans stood out alone as the sole instance of governmental protection of the consumer. In all states and in the federal government, under both political parties, the last half-century has seen an overwhelming tendency to protect the small citizen against business oppression. As examples one may mention the court-created equity of redemption of the mortgagor and the statutory right of redemption from foreclosure; the homestead and debtor's exemption laws; the Interstate Commerce Commission Act for the protection of shippers; the Federal Trade Commission Act for the protection of merchants and consumers; the Securities and Exchange Act and the Blue Sky laws to aid the investing public; the public utilities regulatory acts in aid of the consumers of electricity, gas, transportation, etc.; the insurance laws to protect policy holders from imposition and fraud; many modern statutes regarding conditional sales and finance companies, designed to guard instalment purchasers against deception and overreaching; and statutes preferring wage claims in insolvency or bankruptcy.

The effect of extensive regulation of the small loan business on the volume of loans made by regulated agencies is shown by the estimates of the National Bureau of Economic Research that between 1929 and 1938 outstanding loans of four leading types of agencies increased as follows: small loan companies, from \$200,000,000 to \$375,000,000; industrial banking companies from \$195,000,000 to \$220,000,000; commercial banks from \$5,000,000 to \$250,000,000; and credit unions from \$30,000,000 to \$105,000,000.

Small loan agencies surely have no ground for complaint against regulation from a selfish financial point of view. Figures show that their profits have been adequate and the number of agencies has greatly increased. In the case of two leading small loan companies bank loans have been negotiated by them at 2 per cent and debentures have been sold at from $2\frac{1}{4}$ to $2\frac{3}{4}$ per cent. Their stocks are listed on the New York stock exchange. Dividends on 5 per cent preferred stock and on common stock have been consistently paid for many years and considerable surpluses have been accumulated annually. A committee of the Illinois Senate made a report in 1943 on the net profits of three small loan companies in Illinois for the year ending December 31, 1935, and found that they had left as profits, after all expenses and taxes, sufficient to pay adequate dividends to stockholders.

If small loan regulatory laws had been proved undesirable for business and the general public, one would expect to find numerous repeals of them or else amendments greatly reducing their scope. Instead the record shows

that there has been a slow but steady increase in the adoption of such laws and that amendments have for the most part been in the direction of greater rather than less regulation. In the thirty-odd states which have experimented extensively with small loan regulation the successive legislatures seem to have been satisfied with the effects of these laws.

It would seem that those who advocate the abolition or reduction of small loan regulation are attempting to ride on the coat tails of the wave of revolt which exists against the many laws regulating business, agriculture, and home life, which have grown out of the depression and the war. This feeling of opposition to the continuance of extensive and detailed regulation is undoubtedly to some extent justified and will succeed in causing the repeal of many temporary, emergency statutes and rules which have been thought necessary in depression and wartimes. But legislatures should take care that the tendency to weed out temporary and special regulation which has been found ineffective or which has outgrown its usefulness does not lead to the repeal of those regulatory laws under the police power for which there is a continuing need, not connected in any way with the recent depression or with the war.

Mr. Collins' statements that some penalties under the small loan laws are unduly harsh and are insulting to the honest and conscientious lending agencies surely are not valid arguments for repealing the regulatory laws. At the most it would seem that if his statements are true, they show a case for a reduction in the severity of the penalties and for the creation of uniformity in the penalties affecting all types of lenders. It may well be that the small loan companies can make a case for a reduction in the civil and criminal penalties applying to them. Such a question should certainly be considered in any comprehensive study of the whole problem, preparatory to new legislation. Some penalties and sanctions are surely necessary, if these laws are to be effective. Their existence in the law is no affront to the honest agency. The penalties are there to deter the occasional dishonest or unscrupulous agency. The good citizen has no right to feel insulted because there are laws punishing murder and arson.

It is believed that the advocates of reduction or complete removal of regulation are sadly mistaken if they believe that the spirit of post-war America is going to be sympathetic to the removal of the safeguards which have been established for the protection of the poor or the necessitous borrower. After the common people of the United States have passed through a great war in which every family will have made heavy sacrifices in life and money, they are going to have an even stronger feeling that they must be protected from exploitation and economic hardship. This new invest-

ment in their country which they will have made during the war will make them increasingly jealous of their rights. Having given so much, they will expect even more from their government in the way of economic opportunity, security, and freedom from oppression. One does not have to be a New Dealer to believe that there is more than a germ of truth in the statement of Vice-President Wallace that the end of this war will open an era in which the "common man" will come more fully into his own.

The opponents of abolition or reduction of regulation can point with much effect to the change which has occurred between 1900 and the present, with regard to the character and standing of the small lender. When regulation began, the typical small lender was a social and business outlaw, who was preying on the weak and gullible, and had no respect from legitimate business. Today nearly all agencies which are making small loans are operated by men of good character and financial responsibility who are respected in the business community. The unscrupulous lender is driven to secret operation. His numbers are greatly reduced and his influence is trifling in the states which have adopted regulation.

IF REGULATION, SHALL THE RATE BE PRESCRIBED?

I now pass to my second question, namely, whether, if it be admitted that the states shall apply some regulation to small loan agencies, such regulation should include the fixation of reasonable maximum rates above which such loans may not be made. On this point there is little to be said. If one believes in regulation at all, surely rate control must be included. The very essence of all credit regulation is prevention of extortionate charges, the protection of the hard-pressed and needy debtor from imposition. The arguments given above with respect to regulation in general should control here. I do not believe it is seriously argued that regulation, if continued, should not include rate control. Instead the discussion centers around the form which the statutory rate should take, whether there should be one single form for stating the rate, and how high maximum charges for small loans should be set.

IF RATE REGULATION, A UNIFORM RATE FORM OR DIVERSE FORMS?

What are the arguments for a statutory rate which is fixed by a uniform standard for all lending agencies, even though the actual amount of the rate may differ from agency to agency? What can be said for a statute permitting the statement of the cost of small loans in various forms, at the option of the lender? Is a uniform rate form better than various, diverse rate forms? For example, is it in the public interest to require small lend-

ers to state their rates in all cases in terms of a percentage of the outstanding balance of the loan, or to permit also various other rate forms, such as, for example, a percentage of the amount originally lent, deducted in advance; or such percentage plus various extra charges? At this point we are not arguing which rate form is the better, but merely whether there should be a required single rate form.

Those who, like Mr. Collins, urge a diverse rate form, allege that a variety of rate forms is necessary to meet the different fact situations regarding various borrowers. Some borrowers are better risks than others, some pay promptly and without any expense or trouble to the lender, while others require more investigation cost at the beginning, and more effort and expense in forcing payment. If the lender can fit the form of the rate to the individual borrower, he can protect himself and do justice to the borrower. If the lender has to use the same rate structure for the high-class as well as the low-class borrowers, there is injustice to the former, since they are in effect paying part of the cost of loans to others.

The proponents of the diverse rate form also urge that various forms of rates have been used for many years by various lending institutions, and that both parties have become used to these differing forms, so that business would be disturbed by a change of method. Thus, the commercial banks have generally stated their rate in the form of discount, that is, a percentage of the amount originally lent, collected in advance. Furthermore, if diversity of rate form is permissible, experimentation is encouraged, and with experimentation come progress and improvement in business methods, whereas to set one single form of rate statement puts a strait jacket on the lending business and results in a backward, reactionary condition. It can also be argued that most businessmen who have something to sell can fix the price in any form that is convenient. Why should not the sellers of credit in small amounts have the same privilege? The grocer can sell by the pound, gallon, box, or barrel. The landlord can rent by the room, the apartment, or the house, and by the day, week, month, or year.

In reply to these arguments for a diverse rate form for small loans it should be emphasized that small loan laws are based on the protection of a weak class of borrowers, who because of financial condition, and in many cases lack of education and business experience, are unable to protect themselves. Whether a uniform rate statement should be required should depend on whether such action will tend to bring fair play and low costs to the borrowing class and will also reduce imposition and overreaching. Arguments and analogies based on the theory that the parties are on an

equal footing (either before or after making the loan) and have real freedom of action are not valid.

A single rate form makes for simplicity and ease of understanding. It enables the borrowing class to make ready comparisons between lenders and to choose the most favorable agency. Varied and complex rate forms make for confusion and deception. A single form puts all agencies on a parity in competing for business, while diverse and varying rate forms lay a basis for misleading the public.

A single rate form does not mean that the amount of the rate or loan cost must be the same for each lender. That amount can be varied by the legislature in accordance with its findings as to the costs of making loans in all types of agencies. The fixation of a single rate form in a small loan code does not mean that this rate form cannot be changed in the light of later experience, but it does mean that the selected original rate form is the best which thirty or forty years of experience have evolved.

Of course, the establishment in the statute of a single rate form would temporarily inconvenience lenders who have become accustomed to another form, but if such a uniform rate form is highly advantageous to the borrowing community, the lenders ought not to complain of slight readjustments of an evanescent character.

Should a single rate form be established by any legislature, it is assumed that it will be sufficient in amount to enable the lender to make a reasonable profit. There can be no argument that a uniform form of rate would compel any lender to operate at a loss or without adequate compensation for all risks and expenses. The proponents of diverse rate forms seem to be motivated largely by a desire to do business in a way that is convenient and customary for them, rather than by a consideration of the effect on the borrowing public.

Whenever the federal or state governments have found it necessary to protect the consumer by establishing by law or regulation uniform measures of cost or value they have not hesitated to do so.

IF A UNIFORM RATE FORM, WHICH FORM?

Lastly, if it be admitted for the sake of argument or on the merits, that a single method of stating the cost of small loans should be required of all small lenders, what form should be adopted? Should it be a fixed percentage on the unpaid balance of the loan, or a fixed percentage of the amount of the note deducted from the amount actually advanced to the borrower at the beginning; should it be fixed in dollars and cents instead of in a percentage; should the borrower pay various amounts or percentages for in-

vestigation costs, the use of the money, bookkeeping and office expense, collection expenses, and other items of the lender's outlays; or should there be some combination of these various methods of stating the cost of the loan to the borrower? As previously shown, there is much variety in the present practice and statutory requirements as between various lenders. If a choice must be made, what one form of rate commends itself for the small loan business?

The proponents of discount and extras as a desirable rate form argue that it has been used for a long time by many lending agencies and that they and the public they serve are accustomed to it; that since many banks use this method, there is no reason why it should not be open to small loan companies and other lenders; that it is easier to compute and understand than the percentage on the unpaid balance form; and that lumping all the cost of the loan in the form of a percentage on the unpaid balance emphasizes the cost and leads legislators to make an unfavorable comparison with the usury rate, whereas splitting the cost up into several items and using the discount method makes the rate seem more reasonable and does not encourage legislative attempts to lower the rate.

It is not urged that discount and extras are necessary to enable any lending agency to make a fair profit. Under the percentage on the unpaid balance rate the small loan companies have been making satisfactory profits. Those who argue for a percentage on the unpaid balance of the small loan as the rate form to be required in a model comprehensive small loan code urge that this rate is the simplest and most easily understood, gives the borrower the fullest information and disclosure as to the terms of the loan, and is less open to evasion and subterfuge on the part of the lender. They feel that the advocates of the discount and extras method are in reality seeking to increase the amount of the rate and consequently to turn already adequate and reasonable profits into excessive gains, or to disguise and belittle the going rate.

It is, of course, a question of individual judgment as to what is the simplest and most understandable way of stating the cost of a loan. If one is going to lend \$100 for a year, conceivably the lender can say the cost will be \$6, or 6 per cent, or 6 per cent payable at the end of the loan, or 6 per cent payable in advance; or he can fix a given dollar cost or given percentage and also state that there will be a \$1 investigation fee and a \$1 delinquency fee for each default. It would seem that to the ordinary man a statement of a rate in percentages is equivalent to stating it in dollars per hundred for a year. To the ordinary layman 6 per cent means \$6 per hundred for a year, payable at the end of the year when the loan is paid.

He is paying \$6 for the use of \$100 for one year. It is immaterial whether the rate is stated in percentages or in dollars per hundred for a given period, except that the former is a shorter and less awkward method of expressing the idea. However, I submit that to the layman's mind 6 per cent or \$6 a hundred means, if not explicitly otherwise stated, that such is the cost of getting the use of \$100 for the named period; and if the ordinary borrower finds that the lender is deducting the interest from the amount agreed to be repaid on the face of the note, the borrower is surprised and thinks that a bargain different from what he contracted for is being forced upon him. He ordinarily does not resist because he wants the loan badly and the amount involved is small and he does not realize that deduction in advance, or discount, substantially doubles the rate. Discount, from the point of view of the small borrower, is a deceptive rate statement. It may be clear in all its implications to an experienced businessman or a banker, but to the citizens who patronize small loan departments it is misleading. This makes it an objectionable form of rate statement. To make it a clear form of rate statement would require explanation in advertising and interviews that the interest is to be deducted in advance; that not all the amount purported to be lent is actually lent; if the period of payment is more or less than a year, what the equivalent rate would be on a year's contract; and that the apparent rate is not the real rate. Those who advocate a discount rate statement do not urge any such elaborate explanation. They advocate a condensed rate phrase like "6% discount" which has hidden implications, and ignores the problems involved in delinquency or prepayment.

As to the statement of a rate in percentage form plus extras, two objections can be advanced. If the statute permits extras, it is only the interest rate which will be advertised and not the extras. They will not be stressed at any point, but they will be charged. The borrower will find that his reliance on the advertised rate is misplaced. The advertisement did not say that the percentage given was the sole charge, but the reader naturally thought it was, when nothing was said of extras. In actual practice now where extras are permitted, they are concealed and unexpected charges. When the borrower learns of them, he is surprised, but he does not have the initiative or knowledge to enable him to protest.

Secondly, the statement of the rate in several items, some of which are in percentage form and others in fixed amounts in dollars, even if the rate were spelled out in detail, would be vague and uninformative to the borrower. He cannot easily translate the extras into interest and add them to the interest rate stated by the borrower. Even if he were told that the

cost of \$100 for a year would be 6 per cent, plus an investigation fee of \$2, plus a contingent delinquency fee of \$1 for each default, plus indefinite possible collection fees, he would not have the ability to translate all the costs into an interest rate per year and find out whether it was 7 per cent or 17 per cent.

I submit that a rate for small loans expressed in the form of a given percentage on the unpaid balance of the loan carries to the mind of the average small borrower the best picture of the cost of his loan. It gives fullest disclosure.

And disclosure in transactions involving the consuming public is an idea which has become increasingly accepted in recent years. Federal Reserve Regulation W and the more modern conditional sales laws require the statement of all details of the cost of conditional sales transactions, including insurance, finance charges, the price of the goods, and any other items. In this way an effort is made to shut out the "pack," the hidden profit of the dealer, which was so heartily condemned by the Federal Trade Commission in its investigation of the automobile industry. In this same report the Trade Commission roundly denounced the misleading 6 per cent finance charges which were figured on the original unpaid balance and not on the balance due from time to time. By the Securities and Exchange Act, the Blue Sky laws, and the Trust Indenture Act, every effort is made to bring out into the open all the facts about investments which are being offered to the investing public, to the end that there may be fullest disclosure and no concealment. The Pure Food and Drugs Acts are aimed at giving to the consumer full opportunity for knowledge as to the ingredients and quantities of packaged food and drugs, so that adulteration, short weights, and injurious substances may be avoided. The Federal Trade Commission is constantly fighting against deceptive advertising and trade practices. State and federal laws relating to agriculture contain stringent regulations regarding seeds and agricultural products. These statutes have as their object the prevention of deception of the farmers and the buying public. A well-established attitude of state and federal legislators, regardless of party, has long been to compel persons selling to and otherwise dealing with the consuming public to use the utmost frankness and candor, and to give full information as to what is being offered. Surely, in deciding what form of rate statement should be applied in any modernized small loan code, legislatures should follow this trend toward full disclosure, and should require the rate to be stated in a form which will be the simplest and most intelligible to the lay mind.

Concerning the argument that a rate stated as a percentage on the un-

paid balance invites attack in legislatures, and that a discount with extras would not be so open to criticism, it may be said that when dealing with a legislature entire candor and frankness is the best policy. Nothing is so fatal to a bill as to have a legislator discover a joker in it. If a small loan code were presented with a rate stated in the form of a discount with extra charges, with the thought that the legislature would thus be deceived into thinking that the discount rate was ordinary interest and that the extras were unimportant, and some legislator with a keen mind brought out into the open the fact that the real interest being charged was much higher than the apparent rate, the effect would be very detrimental to the cause of the proponents of the bill. Small loan companies and other advocates of sound small loan laws would better serve their cause by openly and frankly defending a rate per month on the unpaid balance which is justified by actual expenses, even if this task is difficult in view of the surface disparity between the usury rate and the small loan rate, instead of attempting to secure the adoption of a rate which has elements of concealment and will surely be attacked as deceptive.

A strong argument for adopting as the single rate for all small loans the percentage per month on the unpaid balance is that the Russell Sage Foundation has consistently favored this form of rate structure. While banks and small loan companies and other interested parties may differ, and their arguments must be taken as coming from biased and prejudiced parties, the Russell Sage Foundation is absolutely disinterested. It is a philanthropic organization which has followed this subject from the beginning and taken a leading part in its development. Surely its considered opinion that a rate stated in the form of a percentage on the unpaid balance with no extras is the fairest and most informative is worthy of serious consideration.

Some commercial banks have argued that permitting them to charge a discount plus extras does the consumer no harm, even though he is deceived by their form of the rate statement, since the actual cost is lower than that of the small loan companies. Even if the rate of the bank is stated as 6 per cent with possible or actual extras, and the consumer ordinarily believes this means 6 per cent on the amount actually lent, whereas, when the interest is deducted in advance and part payments are made, the actual rate runs up to 12 or 18 per cent a year on the amount lent, it is argued that the deception does the borrower no harm, since he would have to pay 24 per cent to 30 per cent a year to the small loan company. But deception of the public should not be encouraged in a statute, even though it may possibly be harmless in some cases. The borrower should know the

actual cost of his small loan at the bank in order that he may compare the cost easily with the charges of all small lenders, and not merely with those of the small loan companies technically so-called. Any legislature which desires to do the maximum public service in framing its modern small loan code should make it easily possible for the borrower to make a true comparison of the charges of all lenders, without being required to make allowance for deceptions or concealments, harmless or otherwise. If the discount agencies are so sure that their rates are actually lower than those charged by the small loan companies, bringing the difference clearly into the open should increase the business of the discount agencies and benefit the borrowing public. If fair, open competition resulted in reduced rates being offered by the small loan companies, the public would profit even more.

It would seem clear that the public interest calls for a legislative review of all small loan laws and the development of a uniform code based upon experience, and that the central feature of this code should be maximum rates in the simplest and most intelligible form.